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Economic Survey

Spring 2020

Economic Prospects

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Abstract

The coronavirus pandemic and the measures taken to contain it have plunged people's daily routines into chaos and caused companies to run into distress, while at the same time global economic forecasts have suddenly become out of date. The change has been unprecedented in its speed and scale. Finland is no exception.

Coronavirus will hit the Finnish economy hard. Our estimate is that the economy will contract by 5.5% this year as the demand in the export markets will collapse and the measures introduced to contain the virus will restrict mobility and business operations in Finland. The assumption in the forecast is that the measures restricting the level of economic activity will remain in place for three months. This will be followed by a recovery and Finland's GDP is expected to grow by 1.3% in 2021 and 2022. As the estimates concerning the duration of the measures taken to containing coronavirus are constantly changing, it is exceptionally difficult to make any predictions about the future.

All demand items will contract, and the exports will be hardest hit. There will also be a substantial decline in private consumption and private investments. As the total demand falls, the inflation rate will slow down and earnings will no longer rise as rapidly as before.

The acute crisis will be followed by a rapid recovery but not all sectors of the economy will recover at the same pace. Driven by global demand, Finnish exports will recover and as employment is no longer falling, there will be an upturn in consumption. The recovery of investments will take slightly longer.

General government deficit and debt will rise rapidly this year. Shrinking output and the Government measures to support the economy will weaken general government finances. Finland's general government deficit will grow by nearly EUR 14 billion this year, reaching EUR 16.6 billion or 7.2% of GDP. The economic growth expected in the foreseeable future will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in the deficit in the coming years.

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Tiivistelmä

Koronaviruspandemia ja toimet sen leviämisen estämiseksi ovat sekoittaneet ihmisten arkirutiinit, ajaneet yrityksiä ahdinkoon ja kääntäneet talousennusteet ylösalaisin kaikkialla maailmassa. Muutos on ollut ennennäkemättömän suuri ja nopea. Eikä Suomi ole poikkeus.

Koronavirus iskee lujaa Suomen talouteen. Arvioimme, että talous supistuu 5,5 % tänä vuonna, kun kysyntä vientimarkkinoilla hyytyy rajusti ja viruksen leviämistä estävät sulkutoimet rajoittavat liikkumista ja liiketoimintaa Suomessa. Ennusteessa oletetaan, että taloudellista aktiviteettia rajoittavat toimenpiteet kestävät 3 kuukautta. Tämän jälkeen kasvu elpyy ja BKT:n arvioidaan kasvavan 1,3 % vuosina 2021 ja 2022. Koska arviot koronaviruksen leviämistä estävien rajoitteiden kestosta muuttuvat, tulevan kehityksen ennustaminen on poikkeuksellisen epävarmaa.

Kysyntäeristä kaikki supistuvat, eniten vienti. Myös yksityinen kulutus ja yksityiset investoinnit vähentyvät voimakkaasti. Kokonaiskysynnän alentuessa inflaatio ja ansiotason nousuvauhti hidastuvat.

Talous alkaa toipua varsin nopeasti akuutin kriisin päätyttyä, mutta toipuminen on eri tahtista. Vienti toipuu maailmantalouden kysynnän vetämänä ja kulutus kääntyy kasvuun työllisyyden laskun päättyessä. Investointien toipuminen kestää hivenen pidempään.

Julkisen talouden alijäämä ja velka kääntyvät nopeaan kasvuun tänä vuonna. Tuotannon supistuminen ja hallituksen päättämät talouden tukitoimet heikentävät julkista taloutta. Julkisen talouden alijäämä kasvaa tänä vuonna lähes 14 mrd. eurolla 16,6 mrd. euroon eli 7,2 prosenttiin suhteessa BKT:hen. Näkyvissä oleva talouskasvu ei riitä vahvistamaan julkisen talouden rahoitusasemaa ennalleen ja julkinen talous pysyy selvästi alijäämäisenä lähivuosina.

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Coronaviruspandemin och åtgärderna för att stoppa spridningen av den har skapat oreda i människors vardagsrutiner, försatt företag i trångmål och vänt upp och ned på de ekonomiska prognoserna i hela världen. Förändringen har varit exceptionellt stor och snabb. Finland är inget undantag.

Coronaviruset slår hårt mot Finlands ekonomi. Finlands ekonomi beräknas minska med 5,5 procent i år, då efterfrågan på exportmarknaden kraftigt stagnerar och de begränsande åtgärder som vidtagits för att stoppa virusets spridning hindrar rörligheten och affärsverksamheten i Finland. Enligt prognosen kommer de åtgärder som begränsar den ekonomiska aktiviteten att vara i tre månader. Efter det återhämtar sig tillväxten och BNP beräknas öka med 1,3 procent åren 2021 och 2022. Eftersom uppskattningarna över hur länge begränsningarna för att förhindra coronavirusets spridning kommer att vara i kraft ändras dagligen, är det ytterst osäkert att förutse den framtida utvecklingen.

Alla efterfrågeposter minskar, exporten mest. Också den privata konsumtionen och de privata investeringarna minskar kraftigt. När den totala efterfrågan minskar avtar också inflationen och höjningen av inkomstnivån.

Ekonomin börjar återhämta sig relativt snabbt efter den akuta krisen, men återhämtningen sker i annan takt. Exporten återhämtar sig till följd av efterfrågan inom världsekonomin och konsumtionen börjar öka när sysselsättningen inte längre minskar. Återhämtningen i fråga om investeringar tar en något längre tid.

Underskottet i de offentliga finanserna och skulden börjar öka snabbt i år. Minskningen av produktionen och de ekonomiska stödåtgärder som regeringen beslutat om försvagar den offentliga ekonomin. Underskottet i de offentliga finanserna ökar i år med nästan 14 miljarder euro till 16,6 miljarder euro, dvs. 7,2 procent i förhållande till BNP. Den synliga ekonomiska tillväxten räcker inte till för att återställa saldot i de offentliga finanserna och de offentliga finanserna kommer att uppvisa ett klart underskott under de närmaste åren.

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Economic Survey Spring 2020

This survey presents projections for economic growth in the period 2020–2022. In addition to a short-term economic forecast, it also contains a medium-term projection for the Finnish economy extending to the year 2024.

The forecasts and trend projections presented in the survey have been prepared independently by the Ministry of Finance Economics Department based on the Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on multi-annual budgetary frameworks (869/2012).

The forecasts and projections are based on the details of national accounts for 2019 published by Statistics Finland in March 2020 and on other public statistics made available by 26 March 2020. Forecast takes account of the decision taken by the Government in its spending limits discussions on 4 April 2020.

Helsinki April 2020

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FOREWORD

The coronavirus pandemic and the measures taken to contain it have plunged people's daily routines into chaos and caused companies to run into distress, while at the same time global economic forecasts have suddenly become out of date. The change has been unprecedented in its speed and scale. Finland is no exception.

Coronavirus will hit the Finnish economy hard. Our estimate is that the economy will contract by 5.5% this year as the demand in the export markets will collapse and the measures introduced to contain the virus will restrict mobility and business operations in Finland.

All sectors are not affected in the same way. Private services, industries and construction will be hardest hit, whereas wholesale and retail trade as well as energy and water services will be less severely affected. Output in the accommodation, catering and tourism sectors is close to zero as long as the measures to contain the epidemic remain in effect. At the same time, it is clear that output in public services will grow.

The outlook is equally bleak for Finland's general government finances. General government deficit will reach EUR 16.6 billion this year. A sharp fall in output, employment and consumption will mean less tax revenue and higher benefit expenditure. Furthermore, the measures to mitigate the impacts of the epidemic will cost Finland's local and central government billions of euros. The deficits will also cause general government debt to increase by nearly ten percentage points, to 69% of GDP this year. In 2024, the debt-to-GDP ratio might already be close to 80%.

Our forecasts are based on the assumption that the containment measures will remain in place for three months, from mid-March to mid-June. After the restrictions have been lifted, growth will gradually recover during the second half of the year.

Growth will only resume if companies and employment are supported during the restrictions. The support measures will not prevent the output from shrinking during the second quarter of the year. The support is needed to prevent the destruction of economic output potential during the height of the crisis so that the level of economy activity can rapidly recover after the restrictions on mobility and business operations have been lifted.

However, the events may also take a different course. There is significant potential for deviations on both sides of the baseline scenario, especially towards a path that is weaker than the baseline.

Output will contract more than what is forecast in the baseline scenario if the restrictions will remain in place for more than three months in Finland, in countries supplying Finnish manufacturers with intermediate products or in countries where there is demand for Finnish exports, or if the support measures will not prevent large-scale destruction of economic output potential. For example, the OECD has estimated that extending the restrictions by one month will cost about 2% of GDP as lost output.

However, if the pent-up demand generated during the restrictions will be released quickly after the lifting of the restrictions, output growth in 2021 might be substantially faster than forecast.

Everything depends on the severity and duration of the economic downturn. Nobody knows that yet. The danger is that a prolonged downturn will gradually suffocate Finland.

The Government has taken a front-loaded approach to keep the economy going and to help companies hit by the restrictions to survive the crisis. This is the right approach. A situation where financially sound companies are forced into liquidation and temporary layoffs turn into long-term unemployment would be a human tragedy and prolong the economic downturn.

It is inevitable that the bills will have to be paid one day. When the acute stage of the crisis is over, it will be more important than ever to find solutions that will make the economic resources more efficiently and extensively available and that help to consolidate Finland's general government finances.

In that situation, we have to find ways to boost investments, employment and growth so that the public sector can continue to manage its obligations in an ageing Finland.

Introduction

From the economic perspective, the coronavirus pandemic is a global disruption slowing down the level of economic activity in all parts of the world. In addition to a huge negative demand shock, it is a negative supply shock that originated in China and is spreading in the economy through global production chains. Decisions restricting free movement of people and business operations are substantially slowing down the level of economic activity in all parts of the world.

The negative impacts become more severe as the virus spreads and as more people are infected and especially as more extensive and long-term restrictions are introduced to contain the virus. The assumption in the forecast is that the measures restricting the level of economic activity will remain in place for three months. The estimates concerning the duration of the measures taken to contain the coronavirus are constantly updated, making it particularly difficult to forecast developments.

Substantial contraction of the Chinese economy in the first quarter of this year marked the start of the global economic slowdown. Even if the economy will recover during the second half of 2020, the Chinese economy will nevertheless contract by two per cent this year. There has been a substantial decline in the economic activity in Europe. Economic growth in the United States will also turn negative as the centre of the pandemic shifts there. Global output will fall by about two per cent this year. The restrictions on activities will also affect global goods trade during the early part of the year. In 2020 as a whole, world trade will decline by 5% from the previous year.

Finland's gross domestic product will contract by 5.5% in 2020. The impact of the coronavirus is expected to recede and the economy to recover fairly rapidly during the second half of the year. GDP is expected to grow by 1.3% in 2021 and 2022.

Contraction of the world trade during the early part of 2020 will hit Finnish exports and imports. Finnish export companies are closely integrated into international production chains and many companies are dependent on imported components. Finland's foreign trade will recover in the wake of the global recovery during the second half of 2020.

The restrictions introduced to contain the coronavirus epidemic will substantially weaken private consumption this year. Private consumption will contract by 4%. There will be a particularly steep fall in the demand for services from March onwards. Layoffs and unemployment will cut purchasing power, which in turn will also reduce the demand for goods. The decline in consumption will be slowest in the category of daily consumer goods.

The investment environment in Finland is now extremely uncertain as a result of the coronavirus pandemic. The uncertainty may cause companies to postpone investments or to cancel them altogether. Private investments will decline by 10% this year. Uncertainties in the world economy will hit machinery and equipment investments particularly hard and the situation will also prompt companies to postpone investment starts.

The number of employed persons will fall as the pandemic is prompting companies to close down their operations and countries to close borders. The employment rate is expected to decline by two per cent this year to just over 71%.

As the employment rate is falling, there will be a substantial increase in the number of unemployed, and the unemployment rate will reach 8% in 2020. If the restrictions introduced to contain the epidemic will be short-lived, people laid off can return to work soon and the unemployment may only rise moderately.

In 2021-2022, world trade will return to its pre-crisis growth path, and driven by demand in the export markets, Finland's exports will start growing again. A short-lived crisis is not expected to permanently weaken the export sector. The growth in private consumption will also be normalised and it will grow at the same rate as real incomes at 1.5% annually. Private investments will recover more slowly because large forest industry projects will be postponed and housing construction investments will decline further. There will no longer be any fall in housing construction investments in 2022, which will be the biggest single factor supporting GDP growth that year. Faster economic growth and slow rise in nominal wages will gradually boost the demand for labour force in 2021 and 2022. At the same time, working-age population is ageing and the employment rate will rise to 72% in 2022.

Economic growth is expected to fall below one per cent in 2023 and 2024. The slowdown is due to structural factors affecting the economy. The growth potential of the economy is weakened by structural unemployment and a shrinking working-age population. Moreover, the investment rate is decreasing, which will weaken the capital stock and the growth potential of the economy. Total factor productivity is also growing at a slow rate.

Finland will experience a substantial weakening in its general government finances this year. Rapid slowdown in economic growth will reduce tax revenue and increase unemployment expenditure. Measures taken to mitigate the impacts of the coronavirus epidemic will also increase the deficit. The gap between revenue and expenditure will widen and reach EUR 16.6 billion.

All general government sectors will post a deficit. Because of the downturn and the stimulus measures, central government finances will be particularly hard hit. There will be further weakening of local government finances, which were already in difficulties last year. For the first time ever, social security funds will post a deficit as the increase in unemployment and layoffs will boost benefit expenditure and the employment pension contributions are lowered.

The general government deficit will shrink next year as the Finnish economy recovers and the measures taken to mitigate the impacts of the coronavirus epidemic will end. However, Finland's general government finances will not return to their pre-crisis levels. It is estimated that in 2024, general government deficit will still amount to well over EUR 9 billion.

General government debt-to-GDP ratio will start growing sharply. The debt is estimated to increase from just under 60% last year to nearly 79% of GDP by the year 2024.

Finland's GDP is in a steep fall

Finland's economy already weakened during the last months of 2019. Growth was slower than forecast and the output was only about one per cent higher year on year. The Finnish economy was thus poorly equipped to face the year 2020 and the crisis caused by a difficult pandemic. Already in January, all major sectors were pessimistic about the economic prospects. Only the service sector expected higher sales. The impact of the coronavirus was not yet a factor in the estimates.

The impacts of the current crisis are estimated to be at their strongest in the second quarter of the year and a fairly rapid recovery is expected during the third quarter. Restrictions on mobility and the voluntary precautions preceding them already reduced demand during the first quarter. Finland's total output is expected to decrease by 5.5% this year. Value added growth is expected to recover and average 1.3% in 2021 and 2022.

The direct impacts of the pandemic are particularly strongly felt in the service sector. The demand for such services as restaurants and hotels has collapsed. The collapse is so huge that the relatively rapid growth expected for the second half of the year will not be enough to compensate for the losses. As a result of weak demand, the service sector will decline by more than five per cent this year. Boosted by higher spending on healthcare, public services are expected to grow this year.

Industrial production has been hit by a decline in global trade and problems with the supply of components. The forest industry is also severely affected by the crisis. It is already burdened by an increase in the supply of timber, a result of forest damage in Central Europe, and mild weather, which has made harvesting more difficult in Finland. In January, expectations and output in the sector were already down 10%. Finland's total industrial output is expected to shrink by 6% this year. Exports of machinery and equipment account for about 10% of Finland's industrial value added. A global decline in investments will probably also lead to a sharp fall in orders in the metal industry. However, industrial production will recover rapidly and in the last years of the forecast, growth will be close to the average long-term rate of two per cent.

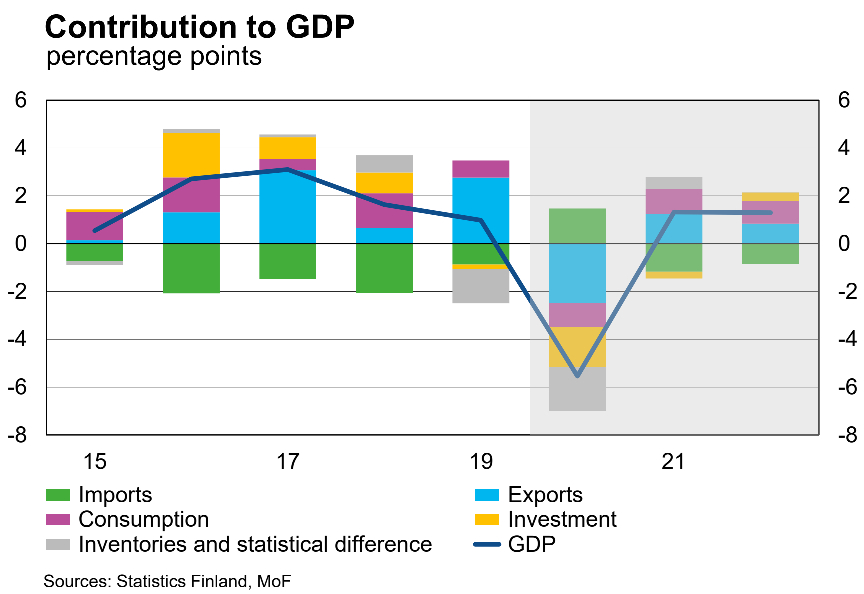
In the construction sector, the coronavirus epidemic may lead to problems with the supply of labour, material shortages and postponement of planned building starts. There may also be delays in renovation construction projects. A sharp reduction in the number of building permits is the main factor behind the predicted fall in construction. A further decline in construction is expected next year and growth is only expected in 2022.

In the baseline scenario, a fall in primary production is also forecast, especially as a result of a substantial contraction of the forestry sector, which already began in the early months of 2020. Fellings will decrease as a result of weak forest industry growth. During the last years of the forecast, the rate of growth will be close to the average of the past 20 years.

In 2019, total value added of the Finnish economy increased by 1.1% year on year. Both primary production and construction posted negative growth figures. Among the main industrial sectors, the forest industry and energy services also contracted. At the same time, however, there was steady growth in the chemical industry and metal industry (including electrical and electronics industry). Private service production increased by two per cent year on year. Information and communications services were among the fastest-growing sectors. There was slight improvement in labour productivity per hours worked last year. In industries, the rise was almost two per cent.

Table 1. **Key forecasts figures**

	2019	2017	2018	2019	2020**	2021**	2022**
	EUR bn	change in volume, %					
GDP at market prices	240	3.1	1.6	1.0	-5.5	1.3	1.3
Imports	95	4.1	5.5	2.2	-3.7	3.0	2.2
Total supply	**335**	**3.4**	**2.7**	**1.3**	**-5.0**	**1.8**	**1.5**
Exports	96	8.8	1.7	7.2	-6.2	3.2	2.1
Consumption	182	0.6	1.9	0.9	-1.3	1.3	1.2
private	126	1.0	1.8	1.0	-4.0	2.7	1.6
public	55	-0.2	2.1	0.9	4.9	-1.6	0.4
Investment	57	4.0	3.7	-0.8	-7.1	-1.2	1.6
private	47	4.8	3.5	-1.0	-10.0	-1.5	2.7
public	10	0.2	5.0	0.3	6.4	-0.2	-2.7
Total demand	**335**	**3.4**	**2.6**	**1.8**	**-4.8**	**2.0**	**1.8**
domestic demand	239	1.5	2.9	-0.3	-4.2	1.6	1.6



Private consumption falls substantially this year

Private consumption increased by one per cent in 2019. Only the consumption of semi-durables, such as clothing and footwear grew at a normal rate (by 2.5%). Other goods categories and services recorded only modest growth. Last year, private consumption increased more slowly than real disposable household income, which grew by 1.5%. Household savings ratio was just above zero.

In January 2020, the volume of retail and car sales increased by more than 3% year on year. Based on known collective agreements, earnings are estimated to rise by 2.1% in 2020, which will boost the disposable income and purchasing power of households.

The emergency measures introduced as a result of the coronavirus epidemic will significantly reduce private consumption this year. The demand for services in particular will decline at an unprecedented rate from March onwards.

The emergency measures are expected to remain in place for about three months, and the situation will only start returning to normal at the end of June. During the emergency measures, demand for the following services is expected to stop almost entirely: passenger transport, leisure, sports and culture services, package travel, restaurant, café and other catering services, and accommodation services. Even though the situation is expected to return to normal during the third quarter, demand for services will decline by 4.5% in 2020.

Layoffs and unemployment will cut purchasing power, which in turn will also reduce the demand for goods. Economic uncertainty will prompt households to postpone the purchase of durables and their sales will fall by 12%. There will also be a decline in the sales of semi-durable and non-durable goods but the fall will not be as steep as in durables.

In overall terms, private consumption will decline by 4% in 2020. When the financial crisis hit Finland in 2009, private consumption fell by 2.9%.In 2021, private consumption is expected to increase by 2.7% and in 2022 by 1.6%.

Investment environment is now extremely uncertain

The investment environment in Finland is now extremely uncertain as a result of the coronavirus pandemic. The availability of investment commodities may be affected by disruptions in production chains, and bottlenecks in investment financing may also arise, which will reduce investments. Construction investments in Finland may also be hit by measures restricting labour mobility. The uncertainty may cause companies to postpone investments or to cancel them altogether.

Public bodies are taking measures to maintain a more favourable investment environment. For example, the European Commission has proposed that cohesion policy appropriations should be immediately channelled to EU Member States to mitigate the effects of the coronavirus pandemic, and that funds from the European Structural and Investment Funds could be used after that. At the same time, the European Central Bank, has decided on a purchase programme of EUR 750 billion, which will stabilise the public sector, the financial markets and the business sector, and thus also the investment environment.

Private investments declined by one per cent in 2019. There was a slight increase in investments in machinery and equipment, while construction and other investments decreased. In the first two quarters of 2020, growth in investments will be extremely weak. Investment growth will accelerate in the second half of the year but will remain below earlier forecasts. Growth in private investments will remain weak in the coming years. On average, private investments will grow by -2.9% during the outlook period, which means that their ratio to GDP will remain below 18% at the end of the outlook period.

There will be a particularly steep decline in housing construction in 2020 and 2021. Even though the number of housing starts was substantially above average in 2019, the figure was well below the totals for 2017 and 2018. Housing starts totalled more than 39,000.

The sharpest fall in housing construction will be experienced in 2020, which is due to the postponement of housing starts during the early months of the year. Housing starts are expected to decline by several thousand until 2021, after which the totals will gradually approach the long-term average (nearly 32,000 starts each year).

There will also be a decline in non-residential building construction investments in 2020 and 2021. However, the last months of 2019 was a busy period in premises construction as starts of public service buildings were at near-record levels. In industrial construction investments, an uncertain investment environment is causing companies to postpone construction projects. Renovation construction investments planned for 2020 will be postponed. Boosted by infrastructure investments, civil engineering construction will grow during the outlook period.

In an uncertain situation, there will be a substantial decline in investments in machinery and transport equipment in 2020 and they will increase again from the second half of 2021. The growth will be supported by stronger demand at the end of the outlook period. The assumption that one of the planned major manufacturing investment projects will be started is the main reason why growth is also expected for the last years of the outlook period. Research and development expenditure will fall at the start of the outlook period, but after that it will increase for the rest of the outlook period. Government R&D funding will also grow in 2020 and 2021.

Several major projects are being planned in Finland, especially in the forest industry, but the launch of these projects will be postponed until the end of 2021 at the earliest. Many of them have been postponed because already before the corona pandemic, investors had withdrawn from the projects. Moreover, lengthy permit processes have also prompted the parties behind the projects to postpone them. The assumption in the forecast is that one of the four major forest industry projects will be launched at the end of the outlook period.

Foreign trade declines as a result of the pandemic

A decline in world trade and in the level of domestic economic activity during the early months of 2020 is expected to hit Finland's exports and imports. Spread of the pandemic in key export markets and disruptions to global production chains are reflected in export demand. Finnish export companies are closely integrated into international value chains and many companies are dependent on imported components. Moreover, global transport restrictions and disruptions to value chains are affecting both exports and imports. Finland's foreign trade will contract in 2020. The outlook for world trade will become less uncertain towards the end of the year and exports and imports will grow from 2021 onwards.

Last year, exports increased by 7.1% year on year and there was particularly rapid growth in service exports. The outlook for exports has weakened rapidly in the first quarter of the year and the decline will be particularly sharp during the second quarter. In overall terms, Finnish exports will contract by 6.2% in 2020. Contraction of output, private demand and investments at global level will reduce goods exports. As capital goods account for a large percentage of Finland's exports, Finnish goods exports will not recover quite as quickly as exports of other countries. Moreover, a decline in the level of economic activity and restrictions on mobility will weaken the outlook for service exports in a number of sectors, especially in tourism and export traffic. ICT and business services are the largest items in Finland's service exports and they are less severely affected by the crisis than sectors that are directly hit by restrictions on mobility. Driven by the recovery of world trade, exports will grow by 3.2% in 2021 and the growth will continue until the end of the outlook period.

Boosted by service imports, total imports increased by 2.5% in 2019. At the same time, however, there was a reduction in the imports of goods last year. The outlook for 2020 has weakened substantially and imports will contract by 3.7%. As export companies have scaled down their production, the need for imported components has also decreased. Imports are also affected by falling domestic demand and restrictions on mobility. Both in exports and imports, the effects of the pandemic are particularly strongly felt in goods trade but imports of services are also affected by restrictions on mobility and growing uncertainty.

Export prices declined in 2019, both in goods and services. Import prices increased slightly last year, which was solely due to a rise in the prices of service imports. Prices of industrial raw materials and oil will fall in 2020. As a result, both export and import prices will decline in 2020. There will be moderate increases in both export and import prices towards the end of the outlook period.

ECONOMIC IMPACTS OF THE CORONAVIRUS EPIDEMIC

Infectious diseases (now COVID-19, in the past, such diseases as AIDS, MERS, SARS and influenza) impact economic activities in many ways. Direct impacts arise from premature deaths, incapacity to work, sickness days and the resources used to treat the patients.

The coronavirus pandemic is also a direct demand negative shock, which mainly affects services. At the same time, it also adds to uncertainty and undermines confidence among companies and households, which impacts demand in many ways.

Supply effects are also created as the pandemic disrupts production chains. In the case of a pandemic, solving the problems is made more difficult by the global nature of the disruptions and it is not easy to circumvent the impacts by relocating operations.

Risky investments include a risk premium, or a requirement for additional returns above the rate of return on a risk-free investment. The coronavirus pandemic increases uncertainties for investment returns, which means higher risk premiums. As a result, companies are postponing investment plans or cancelling them altogether. Temporary difficulties in the supply side may endanger access to funding, and lead to job losses and bankruptcies. A short-term shock may then have negative long-term impacts on potential output. The risk premium on the sustainability of general government finances increases the cost of additional public debt, which will make it more expensive to combat the disease.

There are both short-term and long-term impacts. The duration of the impacts depends on the duration of the pandemic, on whether the pandemic will permanently change consumer behaviour and production chains and on how much production capacity will be destroyed through bankruptcies, changes in production chains and weakened confidence.

In a country’s economy, the impacts are strengthened by intersectoral dependencies. Moreover, in a pandemic, direct and indirect effects spill over from one economy to another. Some of the spill-over effects arise from the demand factors referred to above. By weakening demand in one economy, an epidemic weakens the export opportunities of other economies. Disruptions to production chains slow down production and thus also income formation. A small open economy like Finland is sensitive to the effects of international impact chains. Even if coronavirus had bypassed Finland, Finnish products would had been hit by a global negative shock, which would have disrupted Finnish production chains.

Monetary and fiscal policies are usually only effective in tackling the demand side of economic impacts. More targeted policy measures are needed to mitigate disruptions on the supply side, for example, when it is necessary to prevent bankruptcies in temporary demand disruptions where costs are running but the revenue has stopped. Correct timing, dimensioning and targeting of these measures are essential to ensure their effectiveness.

Slowing down the spread of an infectious disease and lowering the peak of the infections are two of the key policy measures that can limit the impacts of the disease. The problem with quarantines and other restrictions on interaction is that they lower output by reducing supply of labour, and negatively impact income formation and the demand for services. The longer the restrictions remain in place, the higher the costs arising from the measures. Small enterprises and self-employed persons do not necessarily have any buffers to protect them against revenue losses arising from collapsed sales. Prolonged restrictions can hit businesses hard and leave permanent traces in the sector.

According to the Ministry of Finance forecast, the restrictions will remain in place for three months, and they will be followed by a rapid recovery. In that case, the negative impacts on the economy will be short-lived and economic growth will resume fairly quickly. If the restrictions are extended, the impacts on the economy can be more severe. According to the calculation presented in this box, restrictions lasting for six months will deepen the economic contraction this year and slow down the recovery.

Key economic indicators - comparison with Ministry of Finance's spring forecast

	Scenario				MoF's forecast			
	2019	2020**	2021**	2022**	2019	2020**	2021**	2022**
	change in volume, %							
GDP	1.0	-12.0	-0.2	1.5	1.0	-5.5	1.3	1.3
Imports	2.2	-12.7	1.7	2.2	2.2	-3.7	3.0	2.2
Exports	7.2	-18.2	1.2	2.1	7.2	-6.2	3.2	2.1
Private consumption	1.0	-10.5	1.1	1.6	1.0	-4.0	2.7	1.6
Private investment	-1.0	-19.0	-3.7	2.7	-1.0	-10.0	-1.5	2.7
Employment	1.0	-7.0	-2.1	0.5	1.0	-2.0	-0.1	0.5
Productivity	0.0	-5.3	2.0	1.0	0.0	-3.6	1.5	0.8
Unemployment rate, %	6.7	11.3	12.6	12.5	6.7	8.0	8.1	7.9
General government net lending, relative to GDP, %	-1.1	-10.5	-8.1	-8.1	-1.1	-7.2	-4.0	-4.1
General government gross debt, relative to GDP, %	59.4	76.2	82.8	87.8	59.4	69.1	71.5	73.8

According to the calculations, the Finnish economy may contract as much as 12% in 2020. The contraction will be at its deepest in the second and third quarter of the year. After that, growth will rapidly recover at the end of the year but because of the depth of the contraction, pre-crisis levels will not be achieved during 2021. Because the crisis is long, unemployment will rise and there will be losses affecting the production capacity.

In the situation described in the calculation, public-sector measures supporting companies, employment and purchasing power will not be enough to prevent a dramatic fall in output in the second and third quarter of 2020 or to stop the destruction of production potential. When the restrictions on mobility are lifted, the level of economic activity will rise rapidly but will remain well below pre-crisis levels. Unemployment in particular, will reach extremely high levels, which will weaken purchasing power. In some sectors, companies may be able to recover lost production but in the sectors worst hit by the crisis, growth will not resume immediately. Thus, the recovery in 2021 will be slower than under the baseline scenario.

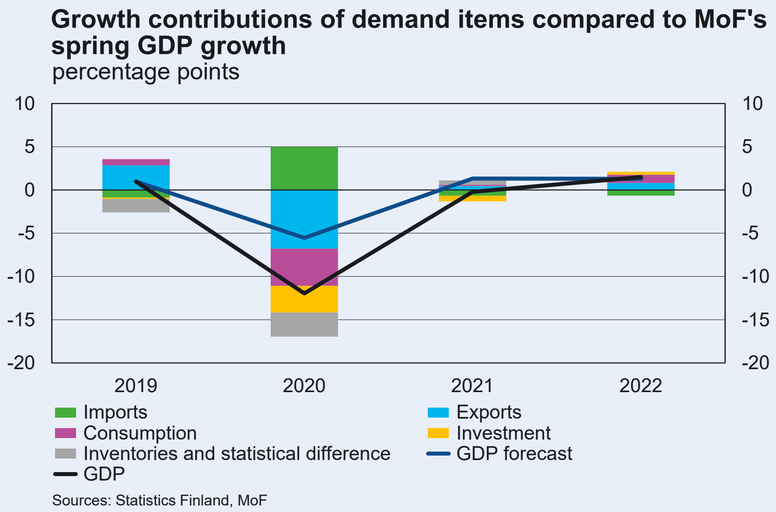


Figure 1. Contribution of demand items to GDP growth - comparison with Ministry of Finance's spring GDP growth forecasts

Sharper contraction of the economy will push general government deficit to over 10% of GDP. Public debt will rise more rapidly and the debt-to-GDP ratio may increase to over 87% by the year 2022. If the crisis deepens and lasts longer, additional measures would probably be needed to mitigate the impacts of the epidemic. In other words, central government would have to shoulder more costs for the epidemic. These pressures have not been taken into account in the scenario.

It is assumed in the calculation that there will not be any additional disruptions to the economy. As the support measures introduced in Finland are ended, the expectation is that this will also happen in the rest of the world. As a result, there would be enough demand for Finnish exports and the recovery would be broad-based. This assumption involves a great deal of uncertainty.

Research into previous epidemics suggests that the restrictions will produce more positive welfare and economic effects if they are imposed early, will severely restrict interaction and contain the spread of the virus, and will remain in place as long as necessary. The restrictions prolong the epidemic by slowing down its spread. However, after extensive and lengthy restrictions, the economy will be better placed to return to growth than after less stringent restrictions that are lifted too early.

In addition to restrictions, the policy planning process should also be founded on two other pillars. The second pillar should promote the maintenance of the operating conditions for production and other activities during the restrictions in a new, very different situation. It is important to prevent unnecessary bankruptcies, erosion of trust and other events that may leave lasting scars so that the economic fundamentals will remain in good shape throughout the 'deep freeze'. The third pillar should provide the basis for the post-pandemic period. It is important that after the restrictions have been lifted, the economy will quickly return to growth path. Measures to boost competitiveness, productivity and employment will then be more important than ever, both in the public and private sectors.

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The pandemic has a profound impact on the world economy

The outlook for the world economy is darkened by the coronavirus pandemic, which broke out in China at the end of last year. The crisis was basically caused by the supply side: production suffers globally as the availability of Chinese-made components needed by well-integrated value chains has been disrupted. The supply-side crisis rapidly expanded into a demand-side crisis. The measures restricting mobility and other activities are reducing private consumption worldwide. The uncertainty has also hit private investments. In China, the crisis peaked during the first quarter of this year, and in the rest of the world during the second quarter. The assumption is that the first half of 2020 is the most difficult period economically and that the world economy will recover during the latter half of the year.

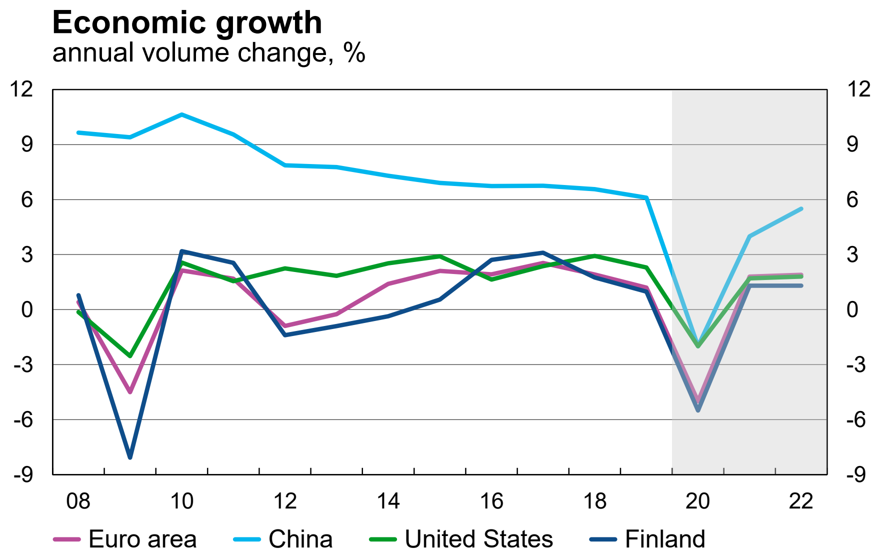
There has been a sharp decline in the level of economic activity in Europe. The German economy has been affected by disruptions to the supply of components and the country's manufacturing companies have been particularly hard hit. In France and in other countries, the level of activity has been reduced by restrictions on citizens' mobility. The situation in Italy, the third-largest economy in the euro area, is particularly difficult. However, the level of activity will recover during the second half of this year. The euro area economy contracts by 5% this year compared with 2019.

In early April 2020, the centre of the pandemic is shifting to the United States. There is a sharp slowdown in economic growth in the United States year on year but the shock caused by coronavirus is eased by extremely strong monetary policy measures and massive fiscal policy support measures at federal level. A rapid rise in unemployment is expected. Total output will contract by 2% this year compared with 2019.

The Chinese economy contracted sharply during the first quarter of 2020. However, there were some signs of recovery in March. Domestic coronavirus infections have practically ceased and there are tentative signs that production is resuming. The recovery is expected to strengthen as the year progresses. GDP will contract by 2% compared with 2019.

Global output shrinks by 2% this year. The contraction is stronger than during the global financial crisis in 2009.

World goods trade decreased by 0.4% last year compared with 2018, and the contraction deepens this year. During the first half of the year, world trade is hit by the restrictions on activities. Container traffic has decreased as containers are stuck in Chinese ports. After the gradual resumption of economic activities in China, world trade will be affected by falling demand in other economies. After contracting sharply during the first half of the year, world trade will recover as activities are resumed. In 2020 as a whole, world trade will decline by 5% year on year.



Sources: OECD, MoF

Table 2. Other key forecast figures

	2017	2018	2019	2020**	2021**	2022**
GDP, EUR bn	226	234	240	229	237	244
Services, change in volume, %	2.5	2.5	1.5	-5.3	1.4	1.3
Industry, change in volume, %	8.4	-1.6	1.0	-6.0	2.0	1.8
Labour productivity, change, %	2.9	-0.8	0.3	-1.6	1.5	1.0
Employed labour force, change, %	1.1	2.6	1.1	-2.0	-0.1	0.4
Employment rate, %	69.6	71.7	72.5	71.2	71.3	71.7
Unemployment rate, %	8.6	7.4	6.7	8.0	8.1	7.9
Consumer price index, change, %	0.7	1.1	1.0	0.7	1.3	1.5
Index of wage and salary earnings, change, %	0.2	1.7	2.4	1.9	2.5	2.3
Current account, EUR bn	-1.7	-3.2	-0.2	-3.1	-3.3	-3.3
Current account, relative to GDP, %	-0.8	-1.4	-0.1	-1.4	-1.4	-1.3
Short-term interest rates (3-month Euribor), %	-0.3	-0.3	-0.4	-0.4	-0.3	-0.1
Long-term interest rates (10-year govt. bonds), %	0.5	0.7	0.1	0.1	0.3	0.6
Gross domestic product, change in volume, %						
World (PPP)	3.7	3.5	2.9	-2.1	2.6	2.4
Euro area	2.5	1.9	1.2	-5.0	1.8	1.9
United States	2.4	2.9	2.4	-2.0	1.7	1.8
China	6.8	6.6	6.1	-2.0	4.0	5.5
World trade growth, %	5.2	3.8	-0.4	-5.0	4.0	2.5

Unemployment is rising again

In 2019, employment grew at the same pace as the economy, which means that there was no improvement in labour productivity. According to the labour force survey, the number of employed persons grew by 1.0% and the employment rate stood at 72.6%. Increase in the number of employed persons was fastest in the service sector, especially in business services. In relative terms, the growth was fastest in primary production. The number of employed persons decreased in secondary production.

The number of hours worked increased considerably more slowly than the number of employed persons, by 0.2%. The average total of hours worked decreased by almost one per cent, to 1,615 hours per employed person. Changes in the number of hours worked per sector was in line with changes in the number of employed persons per sector.

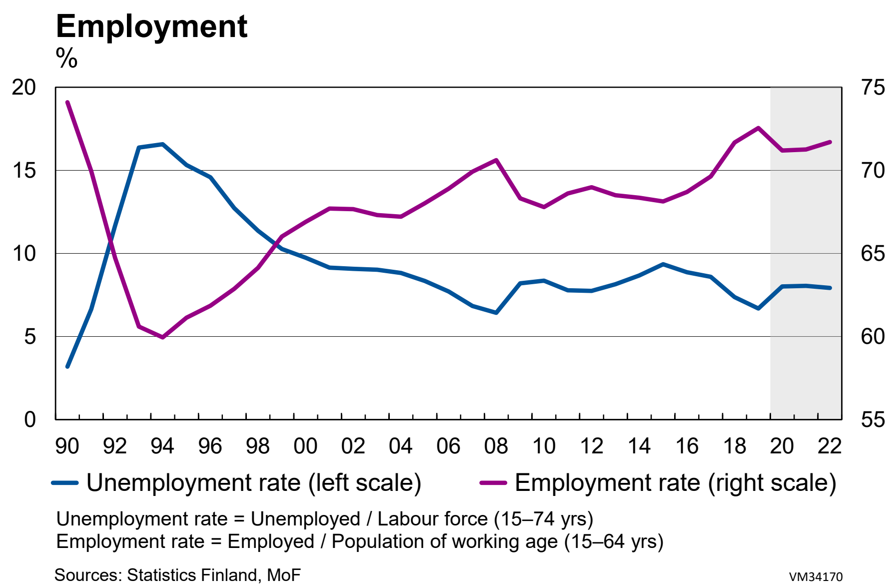
The demand for labour force increased again in 2019. According to Statistics Finland, the number of job vacancies in 2019 was slightly higher than a year before. According to the confidence indicators of the European Commission, the employment expectations of Finnish companies remained at high level in February. However, when measured with the vacancy rate (the percentage of job vacancies of all jobs), demand for labour in Finland was slightly below EU average.

The number of employed persons will fall substantially as the pandemic is prompting companies to close down their operations and countries to close their borders. Making forecasts is particularly difficult amidst growing uncertainty. If the measures taken to contain the epidemic will not extend beyond the first half of this year, increase in the level of economic activity during the second half may stop the fall in employment. In that case, employment might only contract by 2% in 2020 as a whole. This is slightly more than what could be concluded on average based on a 5.5% fall in GDP. The employment rate for 2020 as whole is expected to be at around 71%.

According to the labour force survey of Statistics Finland and the employment service statistics of the Ministry of Economic Affairs and Employment, there was again a rapid decline in unemployment in 2019 and the unemployment rate for the year stood at 6.7%. The last time unemployment fell below 7% was in 2008. Unemployment decreased in all regions and in all age groups.

The downward trend is coming to an end, however. Seasonally adjusted unemployment rate stood at 6.6% in February 2020. Driven by a fall in employment, unemployment will rise significantly in 2020. If the restrictions introduced to contain the epidemic are short-lived and will not lead to a large number of insolvencies and dismissals, the rise in unemployment may also remain moderate. During the early stage of the crisis, companies have announced a large number of layoffs. In the labour force survey, employees laid off are either entered as persons outside the labour force (about 1/2), employed persons (about 1/3) or unemployed (about 1/6). Based on this earlier trend, an unemployment rate of 8% is expected for the whole of 2020.

If the crisis is over by the end of this year, predicted acceleration of economic growth and slower rise in nominal wages will gradually boost the demand for labour in 2021 and 2022. In that case, the number of employed persons could be at the same level as in 2020. The employment rate would rise to 72% in 2022 as the working-age population continues to shrink.



Slower rise in consumer prices

In January-February 2020, the annual change in the consumer price index averaged 0.9%, which means that the inflation has slowed down slightly since the end of 2019. The slowdown is due to a slower service inflation and a moderate rise in food prices. Partially as a result of tax increases, there was a slight rise in energy prices in the early months of 2020.

Inflation will slow down to 0.7% in 2020. As a result of only moderate increase in earnings, the rise in service prices will slow down compared with last year, but they will nevertheless rise faster than the overall index. The fall in oil prices will mean lower energy costs and is directly reflected in slower energy price rises and indirectly in slower increases in goods prices. The emergency measures launched as a result of the coronavirus epidemic will significantly reduce consumption demand this year, which will slow down inflation. The national consumer price index is expected to rise by 1.3% in 2021 and by 1.5% in 2022.

According to expert estimates published by the European Central Bank in March 2020, inflation in the euro area is expected to slow down to 1.1% in 2020, accelerate to 1.4% in 2021 and reach 1.6% in 2022.

More flexibility in wage drifts as the economy slows down

Nominal wages increased by 2.4% in 2019 or faster than a year before. The acceleration was a result of higher rises in negotiated wages. At the same time, however, there was no increase in wage drifts. Private sector nominal wages increased by just over 2% and those in the public sector by slightly over 3%.

A large number of new collective agreements have been concluded in the private sector in the first months of the year. The agreements concluded so far cover hundreds of thousands of private-sector wage earners. On average, nominal wages will rise by slightly less than 1.5% under the agreements. Assuming that the measures introduced to contain the pandemic will substantially reduce the level of economic activity, wage drifts will probably also be smaller than in 2019. If the wage rises negotiated for the public sector are the same as those agreed for the private sector during the early months of this year, nominal earnings would increase by less than 2% this year.

Higher level of economic activity and the resulting rise in employment will probably lead to higher wage drifts in 2021 and 2022. Moreover, the private sector wage rises agreed for 2021 during the early months of this year are about 0.5 percentage points higher. If similar increases are also adopted in the public sector, nominal earnings would rise by about 2.5% in the economy as a whole.

Public finances will weaken substantially

The coronavirus epidemic, the measures taken to contain it and the temporary but sharp weakening of the economic situation will cause a rapid rise in general government deficit and debt. The measures taken to mitigate the impacts of the epidemic and to ease the economic distress of companies will also weaken general government finances. Finland's general government deficit will grow by nearly EUR 14 billion this year, to EUR 16.6 billion or 7.2% of GDP.

Even though the economic disruptions are expected to be short-lived, this exceptional downturn will leave deep traces in general government finances. The economic growth expected in the coming years will not be enough to balance the general government budgetary position and Finland's general government finances will remain substantially in the deficit.

General government finances are also weakened by structural problems. Ageing of the population will automatically increase public spending and weaken the growth potential of the economy, thus slowing down growth in tax revenue. Finland's general government finances have a long-term sustainability problem. Our general government finances are now more poorly placed to face the expenditure pressures arising from the ageing of the population.

There will be a substantial increase in Finland's central government deficit this year. Cyclical variations have a particularly strong impact on central government finances because central government tax revenue is highly sensitive to economic cycles. Central government will also shoulder most of the costs arising from the support measures prompted by the coronavirus epidemic. Central government deficit will start shrinking next year as tax revenue increases and the support measures are ended.

The economic situation of municipalities has become tighter in recent years. The year 2020 will also become very difficult financially in local government as a result of the higher expenditure arising from the economic downturn and the coronavirus epidemic. The local government budgetary position is also burdened by the growing need for health and social services and expenditure as the population is ageing.

Until now, the employment pension funds, which are part of the social security funds, have posted substantial surpluses. In 2020, however, the surplus of the employment pension funds will melt completely for a short period, as the employment pension contributions are temporarily lowered and the weakening of the employment situation will reduce contribution revenue. Moreover, rapid growth in pension expenditure continues and low interest rates are slowing down growth in employment pension funds' property income.

Other social security funds will also post deficits as extensive layoffs, higher unemployment and temporary extension of the unemployment security will boost benefit expenditure.

General government debt-to-GDP ratio will rise by nearly ten percentage points this year, to nearly 70%. The sudden rise in the debt ratio is caused by the contraction of GDP and especially by a large increase in central government and local government deficits. In 2024 the debt ratio may already be close to 80%.

Because of the measures set out in the Government Programme, fiscal policy stance was already slightly expansionary in 2020 before the outbreak of the coronavirus epidemic. The measures introduced by the Government of Prime Minister Marin to mitigate the negative economic impacts of the epidemic will make the fiscal policy stance highly expansionary this year. The fiscal policy for 2021 will become contractionary because most of the temporary support measures will expire by the end of this year. The measures to mitigate the negative economic impacts of the coronavirus epidemic are described in more detail in the box on page 32.

The risks affecting general government finances are closely connected with the overall economic developments. There is considerable uncertainty related to the duration of the coronavirus epidemic and how well the economy recovers once the epidemic subsides.

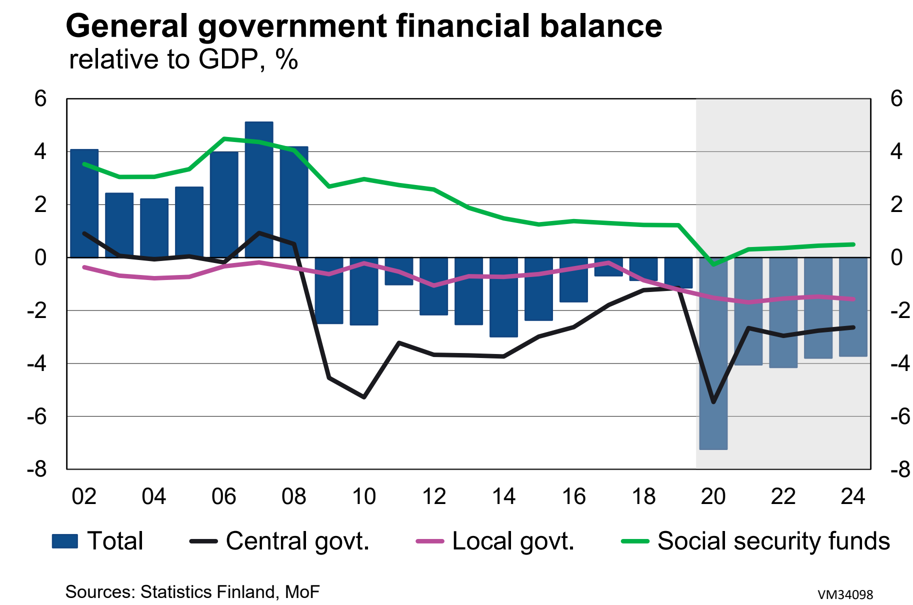
Table 3. Key forecasts figures for the medium term

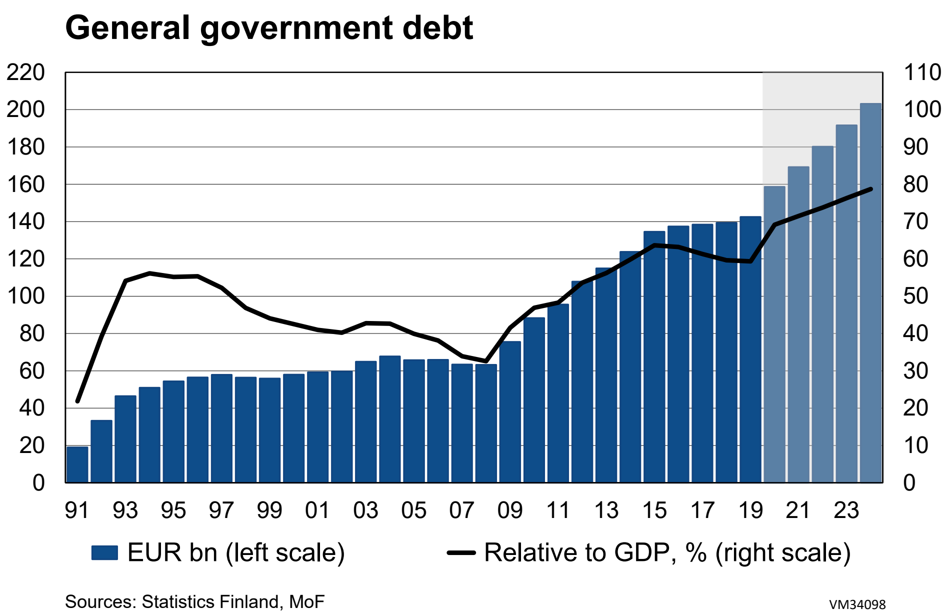
	2019	2020**	2021**	2022**	2023**	2024**
GDP at market prices, change in volume, %	1.0	-5.5	1.3	1.3	1.0	0.8
GDP, EUR bn	240	229	237	244	251	258
Consumer price index, change, %	1.0	0.7	1.3	1.5	1.5	1.6
Unemployment rate, %	6.7	8.0	8.1	7.9	7.8	7.8
Employment rate, %	72.5	71.2	71.3	71.7	71.8	71.8
Taxes and social security contributions, relative to GDP, %	42.1	42.1	43.6	42.8	42.8	42.8
General government expenditure[1], relative to GDP, %	53.3	59.8	57.9	57.2	56.9	56.8
General government net lending, relative to GDP, %	-1.1	-7.2	-4.0	-4.1	-3.8	-3.7
Central government	-1.2	-5.5	-2.7	-3.0	-2.8	-2.6
Local government	-1.2	-1.5	-1.7	-1.6	-1.5	-1.6
Employment pension institutions	0.9	0.0	0.3	0.4	0.5	0.5
Other social security funds	0.3	-0.3	0.0	-0.1	-0.1	0.0
Structural balance, relative to GDP, %	-2.4	-5.2	-2.7	-3.5	-3.5	-3.7
General government gross debt, relative to GDP, %	59.4	69.1	71.5	73.8	76.3	78.7
Central government debt, relative to GDP, %	44.3	51.9	53.2	54.5	56.1	57.5
Output gap, % of potential output[2]	2.1	-3.5	-2.3	-1.2	-0.4	0.0

[1] EU-harmonized definition

[2] Estimated according the method developed jointly by the EU Commission and Member States

The faster and more strongly the economy recovers, the smaller the damages in the public finances will be. On the other hand, if the coronavirus epidemic and the restrictions introduced to contain it will last longer than assumed, tax revenue will contract more than predicted and unemployment expenditure will increase more than forecast. Moreover, general government contingent liabilities and especially the rapid rise in guarantees will pose a risk for general government finances. Guarantee authorisations will also be increased this year as part of the measures introduced to support companies. Extensive realisation of the liabilities would lead to higher public spending and would make the impacts of a higher debt-to-GDP ratio more severe.





MEASURES TAKEN TO MITIGATE THE HARMFUL IMPACTS OF THE CORONAVIRUS EPIDEMIC

Spread of the coronavirus pandemic has major impacts, both direct and indirect, on general government finances. The greatest impacts are caused by the restrictions introduced in Finland and in other countries to contain the pandemic. As a result of these measures, the economy will contract, tax and social contribution revenue will decline and unemployment expenditure and other benefit expenditure will increase. The additional healthcare expenditure required to deal with the epidemic in the short term and the measures introduced to mitigate the harmful impacts of the epidemic will substantially weaken Finland's general government finances during 2020.

The Government has decided on measures intended to support enterprises with grants, loans and guarantees and provided companies with relief on taxes and social security contributions. The purpose of these support measures is to enhance companies' operating prerequisites and to mitigate the long-term impacts of the downturn triggered by the epidemic on growth and employment. The support channelled through Business Finland and ELY Centres is mainly intended for small and medium-sized enterprises. The Government has also made it easier for entrepreneurs to receive unemployment benefits by easing the eligibility requirements for unemployment security. The statutory duration of cooperation negotiations has also been shortened so that employees can become eligible for unemployment security more quickly, thus easing the situation in companies. Likewise, to ease the situation of employees that have been laid off or become unemployed, the Government has removed the waiting period for unemployment security.

In euro terms, the loan guarantees and other measures enhancing the liquidity of companies account for most of the measures introduced to support enterprises. The guarantees do not directly increase general government expenditure but they will increase the risks to general government finances as ultimately, the guarantee losses will be covered from public funds. As part of the support package, the compensation for domestic credit and guarantee losses paid by the state to Finnvera will increase from 50% to 80%. In fact, central government expenditure arising from the guarantee losses will probably increase in the coming years. In the General Government Fiscal Plan, preparations for this expenditure have been made by increasing the appropriation for compensation for Finnvera's losses by about EUR 150 million between 2021 and 2024. In addition, the loans and capital injections to corporations include a risk of losses to public finances. The final costs will only become clear in due course.

The coronavirus epidemic will increase the need for healthcare services and especially the need for specialised medical care. The Government has also allocated more funding for medical equipment, testing and vaccine research. In an exceptional situation, police and border control must also be provided with additional resources, and such sectors as culture and sports also need more support.

The epidemic will weaken the budgetary position of all general government sectors. The impacts on local government healthcare expenditure and sale and fee revenue may be substantial, and the sums concerned may amount to hundreds of millions of euros. However, only rough estimates can be made at this stage. The state will compensate municipalities for the revenue losses caused by delaye payments of taxes through central government transfers.

The Government has also announced that it will prepare a support package for municipalities in the third supplementary budget to be issued in May. This package has not yet been taken into account in this forecast. The financial position of social security funds will be weakened by a temporary lowering of employers' pension contributions and higher unemployment benefits and other social benefits. A significant proportion of the funding for unemployment benefits and most of funding for other social benefits also comes from the state.

Some of the support measures do not have any negative impact on general government net lending. Delayed payments of taxes and social security contributions within one calendar year are not shown in annual revenue forecasts. Furthermore, one-off or temporary payment delays are recognised in the national accounts as general government revenue on an accrual basis for the year in which the payment obligation is created. For this reason, the relief on tax payments and any payment deferrals are not shown in general government net lending recognised in the national accounts but they will increase the borrowing requirement in the short term.

Measures prompted by the coronavirus situation that will impact general government net lending

	2020	2021	2022
	EUR million		
Support for enterprises	1,252	355	206
Of which:			
Grants to enterprises provided by Business Finland and ELY Centres during disruptions	956	200	45
Supporting the liquidity of self-employed persons	250		
Support for agricultural enterprises	47		
Estimated increase in Finnvera's guarantee losses		155	161
Extension of unemployment security: removal of waiting period, speeding up of the layoff procedure, and making entrepreneurs eligible for unemployment security	284		
Extension of social benefits: support for parents of small children and persons arriving from other countries	94		
Healthcare resources and equipment purchases	691		
Other expenditure increases arising from the coronavirus situation	440	2	2
Expenditure increases total	**2,761**	**356**	**207**
Lowering of private-sector pension contributions for the period 1 May - 31 December 2020. Funding will come from the EMU buffer fund of the employment pension scheme. The buffer fund will be augmented again by raising the pension contributions for the period 2022-2025.	-1,050		263
All measures impacting revenue	**-1,050**	**0**	**263**
Total impact on net lending	**-3,811**	**-356**	**55**

Measures with no direct impact on general government net lending

	EUR million
Easing of payment terms for taxes due on or after 1 March 2020 and lowering the interest on late payments from 7% to 4%. Estimated impact of the tax revenue delayed from 2020 to 2021.	1,400
Option of postponing pension contribution payments by three months	
Increasing Finnvera's domestic financing authorisations from EUR 4.2 to EUR 12 billion. About EUR 2 billion of the existing authorisations have been used and thus, additional funding might total EUR 10 billion.	10,000
Higher Business Finland loan authorisations because of the market failure arising from the corona situation 2020-2022	300
Injecting capital into Finnish Industry Investment for the setting up of a new stability programme	150
Easier reborrowing of TyEL (private sector employment pension fund) contributions	
State guarantee to Finnair	600
State guarantees to shipping companies to ensure cargo traffic important to security of supply	600
Lowering of credit institutions' capital requirements	30,000
Bank of Finland's investments in commercial papers	1,000
The investments of State Pension Fund to commercial papers will be increased at most to EUR 1 billion	1,000

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